

**Advisory Committee on the Auditing Profession
Testimony on Firm Structure and Finances
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Members of the Advisory Committee and Treasury Department Staff: I am honored to have been invited to appear today and am happy to give my thoughts on Section VI of the draft report on the Auditing Profession. I will begin with a few brief comments on the draft and then do my best to answer your questions.

This is such a difficult and complex task that even what appear on the surface to be fairly routine housekeeping questions like those pertaining to firm structure and finances can be multifaceted and controversial.

I support draft Recommendation 1 and all of its component parts. Ideally, I would like to see it written with a little more specificity and be more oriented to outputs than to recommendations and the creation of new structures and rules, but I recognize that as the work of a committee, that may not be possible.

I am concerned about vagueness with relation to the “expectations gap.” One of the most surreal aspects of the series of failures of major public corporations in 2001-2002 was the repeated refrain from the accounting and audit profession that “it is not our job to prevent or uncover fraud.” This issue arises in more muted form in the draft:

“Perhaps no single issue is the subject of more confusion, yet is more important, than the nature of the obligation of auditors to detect fraud—or *intentional material misstatement* of financial information by public companies.” (citing *Serving Global Capital Markets and the Global Economy: A View from the CEOs of the International Audit Networks* 12 (Nov. 2006))

The way to close the expectations gap is not to lower the expectation of investors, officers and directors of public corporations, regulators, lenders, and rating agencies but to raise the expectation of auditors and accountants. We do not expect them to be guarantors of every number issued by their clients or even their own firms. But we can expect them to be an independent assessor of the fairness and quality of the numbers as well as their compliance with GAAP and other standards, or auditing and accounting do not add any meaningful value. I appreciate the emphasis in this draft on strengthening the ability of auditors to detect and prevent fraud. I support the idea of better communication about what we can expect from an audit. But I think we should make it clear that it is not just

fair it is right to expect that the primary focus of the auditor's attention is on this issue.

I support draft Recommendation 2 with the proviso that all possible efforts should be made to encourage innovation and particularity rather than safe harbors and uniformity. While consistency has its benefits, the study of regulatory policy in any category shows that uniformity for the sake of consistency and an overly compliance-based approach suffocate originality and eliminate incentives for the development of optimal approaches for varying circumstances. Rules can too easily become the ceiling when they should be the floor. Whenever possible, rules should be on a "comply-or-explain" basis rather than on a prescriptive basis. And independence should always be judged by results, not résumés.

I support draft Recommendation 3, though believe again that we should be open to structural innovation such as a dual board structure. Audit firms are not public companies and are not subject to the same kinds of agency costs as companies whose owners are more diverse and numerous, unable to find and communicate with each other without great cost.

I support draft Recommendation 4, which seems to me very consistent with the provisions of Sarbanes-Oxley.

Again, my thanks, and I look forward to your questions.